

Message Text

CONFIDENTIAL

PAGE 01 BRASIL 00168 01 OF 02 081644Z

47

ACTION ARA-10

INFO OCT-01 EUR-12 IO-10 ISO-00 EB-07 AGR-05 CEA-01

CIAE-00 COME-00 DODE-00 FRB-01 H-01 INR-07 INT-05

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SP-02 FEAE-00 OMB-01 NEA-09 XMB-02 OPIC-03 /120 W

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P R 081520Z JAN 75

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC PRIORITY 7170

INFO USMISSION BRUSSELS

USMISSION GENEVA

AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

C O N F I D E N T I A L SECTION 1 OF 2 BRASILIA 0168

E.O. 11652: GDS

TAGS: EFIN, BR

SUBJECT: BRAZIL'S IMPORT PROGRAM AND BALANCE OF PAYMENTS PROSPECTS

REF: BRASILIA 142

THIS IS THE SECOND OF SERIES OF THREE MESSAGES.

1. SUMMARY: THE EMBASSY'S BALANCE OF PAYMENTS FORECAST FOR 1975 INDICATES THAT BRAZIL THIS YEAR WILL BE FACED WITH A SIZEABLE EXTERNAL FINANCIAL GAP. THIS IS THE RESULT BY OUR FORECASTING MODEL WHICH PRETTY MUCH ACCEPTS THE RELATIVELY OPTIMISTIC WORKING ASSUMPTION OF THE GOB THAT BRAZIL CAN INSULATE ITSELF FROM THE WORLDWIDE RECESSION AND CONSEQUENT DECELERATION IN WORLD TRADE. ASSUMING CONTINUED STRONG PRICES AND GOOD HARVESTS, PARTICULARLY FOR SUGAR, SOYBEANS AND COFFEE, WE PROJECT THAT TOTAL EXPORTS COULD REACH THE \$9-\$10 BILLION RANGE, UP FROM AN ESTIMATED \$7.7 BILLION IN 1974.

CONFIDENTIAL

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PAGE 02 BRASIL 00168 01 OF 02 081644Z

ON THE IMPORT SIDE, THE RESTRICTIVE POLICY NOW IN FORCE TOGETHER WITH

THE EXPECTED DRAWDOWN OF INVENTORIES SHOULD HELP KEEP IMPORTS WITHIN THE \$12.4-\$12.9 BILLION RANGE IN 1975, WHICH SHOULD BE ONLY SLIGHTLY ABOVE THE ESTIMATED \$12.4 BILLION FOR 1974. THE TRADE DEFICIT IS THUS FORECAST TO BE ON THE ORDER OF \$2.4-\$3.9 BILLION, AS COMPARED WITH A DEFICIT OF \$4.7 BILLION IN 1974. WHETHER THE ACTUAL BALANCE WILL BE TOWARD THE LOWER OR UPPER POINT OF THE RANGE DEPENDS TO A SIGNIFICANT DEGREE ON THE BEHAVIOUR OF AGRICULTURAL EXPORTS. ALLOWING FOR TRADITIONAL DEFICIT OF THE SERVICES ACCOUNT, WE PROJECT A CURRENT ACCOUNT DEFICIT OF \$5.0-\$6.5 BILLION. WITH A DEBT AMORTIZATION OF ABOUT \$1.8 DUE IN 1975, THIS IMPLIES A TOTAL EXTERNAL FINANCIAL GAP OF \$6.8-\$8.3 BILLION AS AGAINST \$8.7 BILLION IN 1974. THUS, UNLESS BRAZIL SUCCEEDS IN OBTAINING SUBSTANTIAL AMOUNTS OF ARAB MONEY AND IN ATTRACTING A SIZEABLE FLOW OF FOREIGN BANK LOANS, IT WILL PROBABLY NEED TO RESORT TO IMF AND OTHER OFFICIAL BORROWINGS (INCLUDING SWAPS) IN ORDER TO PREVENT OFFICIAL RESERVES FROM DROPPING TO A DANGEROUSLY LOW LEVEL. END SUMMARY.

2. THE PRINCIPAL OBJECTIVE OF POLICY MAKERS IN 1975 IS TO REDUCE THE CURRENT ACCOUNT DEFICIT FROM THE UNACCEPTABLY HIGH LEVEL OF 1974. AUTHORITIES HAVE MADE IT CLEAR THAT THEY ARE PREPARED TO ACCEPT A CONSIDERABLE DROP IN THE GROWTH RATE TO ACHIEVE THIS GOAL.(SEE BRASILIA 9013). WITH A TOTAL FOREIGN DEBT OF CLOSE TO \$18 BILLION AND AN OFFICIAL RESERVE LEVEL OF \$5.0 BILLION AT THE END OF 1974, AUTHORITIES HAVE NO CHOICE BUT TO NARROW THE EXTERNAL GAP IN 1975. THE MEANS BY WHICH THIS TARGET IS TO BE ACHIEVED ARE ESSENTIALLY THREE: (A) SLOWING DOWN THE GROWTH RATE; (B) IMPLEMENTING A TIGHT IMPORT POLICY AND (C) CONTINUING THE EXPORT DRIVE, HOPING IN PARTICULAR THAT A GOOD CROP YEAR WILL SUBSTANTIALLY INCREASE AGRICULTURAL EXPORTS; AUTHORITIES EXPECT AGRICULTURAL PRICES TO REMAIN STRONG DURING THE COURSE OF THE YEAR.

3. GIVEN THESE GENERAL PARAMETERS, THE EMBASSY, WITH
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 BRASIL 00168 01 OF 02 081644Z

INPUTS FROM CONGENS RIO AND SAO PAULO, HS FORECAST BRAZIL'S BALANCE OF PAYMENTS FOR 1975. FOLLOWING IS THE BREAKDOWN OF OUR 1975 PROJECTIONS(COMPARABLE 1974 DATA ARE GIVEN IN PARENTHESIS); ALL FIGURES ARE IN MILLIONS OF US DOLLARS, UNLESS OTHERWISE STATED:

4. TRADE BALANCE. WE ARE PROJECTING A RANGE FOR THE TRADE BALANCE. AT THIS STAGE THERE ARE STILL

TOO MANY UNKNOWN, ESPECIALLY WITH REGARD TO AGRICULTURAL OUTPUT AND EXPORTS, TO PERMIT US TO MAKE A MORE DEFINITIVE FORECAST. AUTHORITIES EXPECT A SIGNIFICANT INCREASE IN AGRICULTURAL EXPORTS IN 1975 AND ARE COUNTING HEAVILY ON THREE COMMODITIES, (SUGAR, COFFEE AND SOYBEANS) TO BOLSTER EXPORT EARNINGS. UNLESS AGRICULTURAL PRICES TAKE AN UNEXPECTED SLIDE DURING THE YEAR, IT WOULD SEEM REALISTIC TO EXPECT A CONSIDERABLE INCREASE IN BRAZIL'S AGRICULTURAL EXPORTS. BECAUSE AGRICULTURAL EXPORTS ACCOUNT FOR MORE THAN 60 PERCENT OF TOTAL EXPORTS AND BECAUSE EXPECTATIONS ARE FOR A RELATIVELY GOOD YEAR FOR AGRICULTURAL PRODUCTS, AUTHORITIES BELIEVE THAT THIS CAN INSULATE BRAZIL FROM THE WORLDWIDE ECONOMIC STAGNATION AND CONSEQUENT SLOWDOWN IN WORLD TRADE.

5. WITH RESPECT TO IMPORTS, MACHINERY HAS ALREADY BEEN SET UP TO KEEP A CLOSE WATCH ON IMPORTS OF THE PUBLIC AND MIXED ENTERPRISES (WHICH ACCOUNT FOR CLOSE TO 50 PERCENT OF TOTAL IMPORTS), WHILE THE RECENT INCREASE IN TARIFFS SHOULD HOLD DOWN IMPORTS OF THE PRIVATE SECTOR. THIS TIGHT IMPORT POLICY TOGETHER WITH THE EXPECTED DRAWDOWN OF INVENTORIES OF IMPORTED COMMODITIES SHOULD HELP TO CONTAIN IMPORTS DURING THE YEAR.

6. OUR FIRST TRADE FORECAST, THE MORE OPTIMISTIC OF THE TWO, FORESEES A TRADE DEFICIT IN 1975 OF 2,400 (ESTIMATED 4,700). THIS PROJECTS EXPORTS AT 10,000 (7,700) AND IMPORTS AT 12,400 (12,400). THE SECOND FORECAST, THE MORE PESSIMISTIC, PUTS THE 1975 TRADE DIFICIT AT 3,900. THIS FORESEES EXPORTS AT 9,000 AND IMPORTS 12,900.

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 BRASIL 00168 01 OF 02 081644Z

CONFIDENTIAL

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CONFIDENTIAL

PAGE 01 BRASIL 00168 02 OF 02 081629Z

47

ACTION ARA-10

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L-02 LAB-04 NSAE-00 NSC-05 PA-01 RSC-01 AID-05

CIEP-01 SS-15 STR-01 TAR-01 TRSE-00 USIA-06 PRS-01

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FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC PRIORITY 7171

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C O N F I D E N T I A L SECTION 2 OF 2 BRASILIA 0168

7. ASSUMPTIONS:

8. EXPORTS: ON THE EXPORT SIDE, WE ANTICIPATE THAT MOST OF THE INCREASE IN EARNINGS WILL COME FROM THE THREE MAJOR AGRICULTURAL COMMODITIES: SUGAR, COFFEE AND SOYBEANS. ON SUGAR, WE ESTIMATE TOTAL FOREIGN EXCHANGE EARNINGS AT ABOUT 2,000 (1,300), WITH TONNAGE GOING FROM ABOUT 2.3 MILLION TONS IN 1974 TO ABOUT 2.7 MILLION TONS IN 1975; AVERAGE PRICES ARE ASSUMED TO BE IN THE \$700-\$750 PER TON RANGE. ON COFFEE (BEANS AND PROCESSED), WE SEE TOTAL FOREIGN EXCHANGE EARNINGS REACHING 1,450 (900), WITH TONNAGE GOING TO 1.1 MILLION TONS FROM ABOUT .8 MILLION TONS; GIVEN BRAZIL'S BIG CROP IN 1975, WE EXPECT PRICES TO SOFTEN; THEREFORE, WE ARE ASSUMING AVERAGE PRICES TO BE TOWARD THE LOWER POINT OF THE 60-70 CENTS PER
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 BRASIL 00168 02 OF 02 081629Z

POUND RANGE. WITH RESPECT TO SOYBEANS (AND SOYBEAN MEAL, WE PROJECT TOTAL EARNINGS AT 1,500 (900) WITH TONNAGE GOING FROM ABOUT 4.6 MILLION TONS (2.8 MILLION TONS OF BEANS AND 1.8 MILLION TONS OF MEAL) TO 7.0 MILLION TONS (4.5 MILLION TONS OF BEANS AND 2.5 MILLION TONS OF MEAL). WE ARE ASSUMING AN AVERAGE SOYBEAN PRICE OF \$250 PER TON AND AN AVERAGE SOYBEAN MEAL PRICE OF \$150 PER TON. THUS, THESE THREE COMMODITIES ALONE WOULD ACCOUNT FOR 1,850 OF THE

EXPECTED INCREASE OF 2,300, UNDER THE FIRST (OPTIMISTIC) FORECAST. WE WOULD EXPECT ABOUT ONE-HALF OF THE REMAINING EXPECTED INCREASE TO COME FROM ALL OTHER AGRICULTURAL PRODUCTS AND ABOUT HALF FROM EXPORTS OF IRON ORE AND MANUFACTURED PRODUCTS. WE ANTICIPATE MOST OF THE ADDITIONAL EARNINGS FROM MANUFACTURED PRODUCTS AND IRON ORE TO COME FROM PRICE INCREASES (WITH PERHAPS QUANTITIES GOING DOWN FOR MANUFACTURED PRODUCTS). WHETHER THE OPTIMISTIC OR PESSIMISTIC FORECAST IS REALIZED DEPENDS ESSENTIALLY ON THE PERFORMANCE OF THE MAJOR AGRICULTURAL COMMODITIES (BOTH IN TERMS OF PRICES AND QUANTITIES).

9. IMPORTS: WE BELIEVE THAT THE IMPORT MEASURES TAKEN BY THE GOB (SEE BRASILIA 142) WILL PROVIDE AN EFFECTIVE BRAKE ON IMPORT GROWTH NEXT YEAR. IN ADDITION, EXISTING EXCESSIVE STOCKS OF MANY IMPORTED COMMODITIES WILL HOLD DOWN IMPORT DEMAND IN 1975 AS THESE INVENTORIES ARE DRAWN DOWN TO MORE NORMAL LEVELS. TECHNICAL LEVEL OFFICIALS AT THE CENTRAL BANK, THE FINANCE MINISTRY AND PLANNING MINISTRY ARE SKEPTICAL ABOUT ACHIEVING A DROP IN IMPORTS IN 1975 (CONTRARY TO THE EXPECTATIONS OF SOME SENIOR OFFICIALS), MOST OF THESE TECHNICAL LEVEL INDIVIDUALS EXPECT SOME INCREASE IN IMPORTS, SAYING THAT AT BEST IMPORTS IN 1975 MAY BE NO GREATER THAN IN 1974. WE TEND TO AGREE WITH THESE VIEWS. WE FEEL THAT THE EXPECTED DRAWDOWN OF THE REPORTED EXCESSIVE INVENTORIES IN STEEL, COPPER, PLASTICS, AND FERTILIZER WOULD PROBABLY DO NO MORE THAN SATISFY A PORTION OF THE INCREASE IN NOMINAL DEMAND DURING THE YEAR. UNFORTUNATELY, BRAZIL DOES NOT HAVE ADEQUATE INVENTORY STATISTICS TO PERMIT

CONFIDENTIAL

PAGE 03 BRASIL 00168 02 OF 02 081629Z

US TO MAKE A MORE DEFINITIVE JUDGMENT ON THIS. WE ESTIMATE OIL IMPORTS IN 1975 AT ABOUT 2,800 (2,500).

10. SERVICES: THE SERVICE ACCOUNT WILL CONTINUE TO BE HEAVILY IN DEFICIT DURING 1975. WE PROJECT TOTAL NET SERVICES AT A NEGATIVE 2,600 (2,300). THE MAJOR INCREASES ARE EXPECTED TO OCCUR ON INTEREST PAYMENTS TO 850 IN 1975 FROM 550 IN 1974 (GROSS INTEREST INCOME WILL BE LOWER NEXT YEAR AS RESERVES HAVE DECLINED); FREIGHT AND OTHER TRANSPORTATION COSTS, TO 870 FROM 800; AND DIVIDEND PAYMENTS TO 250 FROM 200.

11. CURRENT ACCOUNT BALANCE: GIVEN THE ABOVE TRADE AND SERVICE ACCOUNT BALANCES, THE CURRENT ACCOUNT DEFICIT IN 1975 IS ESTIMATED AT BETWEEN 5,000 AND

6,500 (7,000).

12. TOTAL FINANCIAL GAP: IN ADDITION TO FINANCING THE CURRENT ACCOUNT DEFICIT, BRAZIL WILL NEED TO AMORTIZE IN 1975 ABOUT 1800 OF ITS OUTSTANDING FOREIGN DEBT. AS A RESULT, THE TOTAL FOREIGN FINANCIAL GAP FOR 1975 IS EXPECTED TO FALL IN THE RANGE OF 6,800 TO 8,300 (DEPENDING ON THE SIZE OF THE CURRENT ACCOUNT DEFICIT), AS COMPARED WITH AN ESTIMATE OF 8,700 THIS YEAR.

13. AVAILABLE FINANCING: TWO POSSIBLE HYPOTHESES CAN BE ASSUMED WITH RESPECT TO AVAILABLE FINANCING. FIRST, BRAZIL WOULD FIND IT DIFFICULT TO ATTRACT FOREIGN BANK LOANS ON A SCALE SIMILAR TO RECENT YEARS AND SUFFICIENT TO MEET 1975 NEEDS. UNDER THIS ASSUMPTION THE ONLY ASSURED SOURCE OF FUNDS WOULD BE IMPORT FINANCING (NET 1,100-1,200) AND FOREIGN DIRECT INVESTMENT FLOWS (1,300-1,400). THUS, BRAZIL WOULD BE REQUIRED TO SEEK FINANCING FROM THE IMF AND OTHER OFFICIAL SOURCES, INCLUDING DIRECT GOVERNMENT-TO-GOVERNMENT LOANS FROM THE ARAB GOVERNMENTS AND OFFICIAL SWAPS, IN ORDER TO PREVENT OFFICIAL RESERVES FROM DROPPING TO A DANGEROUSLY LOW LEVEL. THE SECOND HYPOTHESES FORESEES A CONSIDERABLY EASIER SITUATION. THIS ASSUMES AN INCREASED BULLISHNESS
CONFIDENTIAL

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PAGE 04 BRASIL 00168 02 OF 02 081629Z

TOWARD BRAZIL (CONNECTED PRIMARILY WITH THE RECENT OIL STRIKE), WITH FOREIGN BANK LOANS CONTINUING TO COME IN AT SUFFICIENT HIGH RATES TO MEET FINANCING REQUIREMENTS. (HOWEVER, BRAZIL WOULD STILL HAVE TO MAKE EVERY EFFORT TO REDUCE THE FINANCIAL GAP SINCE, WITH A FOREIGN DEBT OF CLOSE TO \$18 BILLION, IT CANNOT EXPECT TO INCREASE ITS FOREIGN OBLIGATIONS AT THE RATE OF RECENT YEARS.) IN ADDITION, THIS HYPOTHESIS ASSUMES THAT BRAZIL WOULD RECEIVE SUBSTANTIAL AMOUNTS OF MONEY FROM THE ARABS, EITHER IN THE FORM OF DIRECT INVESTMENT, GOVERNMENT-TO-GOVERNMENT LOANS, OR A COMBINATION OF BOTH, (SOME OF THE ARAB GOVERNMENTS ARE REPORTEDLY ALREADY NEGOTIATING NEW PROJECT FINANCING WITH BRAZIL.) UNDER THIS ASSUMPTION, BRAZIL WOULD BE ABLE TO FINANCE ITS EXTERNAL FINANCIAL GAP WITHOUT RECOURSE TO THE IMF AND NON-ARAB OFFICIAL SOURCES AND RESERVE LOSSES WOULD BE MINIMAL.
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